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GLOSSARY

BOC	Bell operating company
ILEC	Incumbent local exchange carrier
IXC	Interexchange carrier
LEC	Local Exchange Carrier
MCI	Petitioner MCI WorldCom, Inc., petitioner AT&T Corp., petitioner Time Warner Telecom Inc., and the petitioners' supporting intervenors
MSA	Metropolitan Statistical Area
POP	Point of presence
RSA	Rural Service Area
UNE	Unbundled network element

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NO. 99-1395 (AND CONSOLIDATED CASES)

MCI WORLDCOM, INC., et al.,

PETITIONERS,

V.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,

RESPONDENTS.

ON PETITIONS FOR REVIEW OF AN ORDER OF THE
FEDERAL COMMUNICATIONS COMMISSION

BRIEF FOR FEDERAL COMMUNICATIONS COMMISSION

JURISDICTION

The Federal Communications Commission adopted a final order and amended rules expanding the pricing flexibility that price cap local exchange carriers have in setting rates for certain services. *Access Charge Reform*, 14 FCC Rcd 14221 (1999) ("*Order*") (JA 232). This Court has jurisdiction to review the *Order* pursuant to 47 U.S.C. § 402(a) and 28 U.S.C. § 2342(1).

STATEMENT OF ISSUES PRESENTED

1. Whether the Commission's decision to grant additional, limited pricing flexibility was reasonable.

2. Whether the Commission was obligated, as a matter of law, policy, or precedent, to consider market share in deciding whether to grant pricing flexibility.

STATUTES AND REGULATIONS

Pertinent statutes and regulations are set out in the Statutory Appendix to this brief.

COUNTERSTATEMENT

The order on review continues the Commission's efforts to enable local exchange carriers (LECs)[1] to adjust their interstate access prices in order to respond to competition as it develops. The Commission has increased LECs' pricing flexibility, through measured steps, over the past decade. In the midst of that process, Congress passed the Telecommunications Act of 1996 (1996 Act), which dramatically increased opportunities for competition, particularly in the local exchange and exchange access markets. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). In light of the increasingly competitive environment that the 1996 Act created, the Commission decided once again to consider LEC pricing flexibility. The order on review is the product of that consideration and is designed to help provide consumers with the benefits associated with competition.

The Commission's decision balances the needs of incumbent LECs for additional pricing flexibility to respond to competition with the need to retain adequate protections to ensure that LECs do not take advantage of their market position to charge unreasonable rates or restrict competitive entry. The Commission established a staged approach for granting pricing flexibility: it authorized certain types of increased pricing flexibility immediately, and it

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[1] The definition of a "local exchange carrier" is set forth in 47 U.S.C. § 153(26). The definition of an "incumbent local exchange carrier," for purposes of section 251, is set forth in 47 U.S.C. § 251(h)(1). As used herein, the terms "LEC," "price cap LEC" and "ILEC" all refer to carriers that are subject to price cap regulation, unless otherwise noted.

identified competitive conditions that, if met, would allow additional pricing flexibility in the future. In all cases, the Commission retained adequate regulations to limit the LECs' ability to charge unreasonable rates and to increase the opportunities for consumers to benefit from competitive entry.

I. BACKGROUND

A. Competitive Developments in the Interstate Access Market.

For much of this century, most telephone customers obtained both local and long distance services from AT&T and its affiliates. In the mid-1980s, pursuant to an antitrust consent decree known as the Modification of Final Judgment or MFJ, AT&T divested its local exchange operations. *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 141-42 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). Pursuant to the MFJ, AT&T continued to provide long distance (or interexchange) service in a market that already was subject to some competition; and the divested companies (the Bell Operating Companies or BOCs) provided local exchange service on a *de facto* monopoly basis.

When a customer makes a long distance call, the interexchange carrier (IXC) must have "access" to the local networks at both ends of the call, so that it can complete the connection between the calling and the called parties. Local carriers recover their costs of providing such access primarily through interstate access charges assessed on the IXC. The Commission has established rules that govern the interstate access charges that incumbent local exchange carriers (ILECs) may impose. *See* 47 C.F.R. Part 69. Part 69 identifies two basic categories of access services: special access services and switched access services. *Order* ¶ 8 (JA 237). Special access services do not use local switches but instead employ dedicated lines that run between the

customer and the IXC's point of presence (POP) in the local exchange area.[2] *Id.* Because special access services employ dedicated facilities, special access is typically used by IXCs and large businesses with high traffic volumes. *Order* ¶ 142 (JA 306); MCI Br. at 3. Switched access services use local exchange switches to originate and terminate interstate long distance calls. *Id.*

In the 1980s, competitive access providers (CAPs) challenged the LEC monopolies and began to offer limited end-to-end special access services in competition with ILECs by building their own transport facilities in order to serve the IXCs. *See Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd 7369, 7373 (1992), *recon.*, 8 FCC Rcd 127 (1993), *rev'd in part and remanded in part, Bell Atlantic Telephone Cos. v. FCC*, 24 F.3d 310 (D.C. Cir. 1993) (*Special Access Expanded Interconnection Order*). In 1992, the Commission adopted rules that enabled CAPs to "collocate" their equipment at a LEC's wire centers and to interconnect their facilities there with the LEC's network. 7 FCC Rcd at 7372. These rules were the first of a series of FCC "expanded interconnection" orders providing opportunities for interstate access competition against the LECs.

B. Regulatory Framework.

(1) Price Cap Regulation.

Even before the Commission imposed collocation obligations on LECs, it had modified the regulation of LECs' interstate access charges in a manner that granted the LECs substantial

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[2] A POP is the physical point where an IXC connects its network with a local exchange carrier's (LEC's) network. An interstate call typically moves from the customer premises to the LEC's end office (this portion of the call may be referred to as channel termination), from the end office to the serving wire center (this portion may be referred to as interoffice transport), and then from the serving wire center to the POP (this may be referred to as entrance facilities).

pricing flexibility. For many years, the incumbent LECs and other communications carriers had been subject to rate of return regulation. In October 1990, the Commission replaced this type of regulation for the largest LECs -- including the Bell Operating Companies -- with an incentive-based system employing price ceilings or "caps" on the aggregate prices the carriers charge for their interstate offerings. *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786 (1990) (*Price Cap Order*), *modified on recon.*, 6 FCC Rcd 2637, *further recon. dismissed*, 6 FCC Rcd 7482 (1991), *aff'd. National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993). The price cap system, codified in Part 61 of the Commission's rules, is designed to replicate some of the efficiency incentives present in fully competitive markets and to act as a transitional regulatory mechanism on the way to full competition. *Order* ¶ 11 (JA 238).

The LECs have greater pricing flexibility under price caps than under rate of return regulation. Under price caps, the LECs do not have to base their rates strictly upon the accounting costs of providing each service. Rather, interstate rates that fall at or below a price cap for a group of services known as a "basket"[3] and within the specified pricing parameters for service categories within the basket are presumed lawful and are given "streamlined" review. *Price Cap Order*, 5 FCC Rcd at 6788 (¶¶ 11-12). *See Bell Atlantic Telephone Companies v. FCC*, 70 F.3d 1195, 1198 (D.C. Cir. 1996). Rates that fall outside these price constraints face more exacting regulatory scrutiny. *Id.*

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[3] At the time the Commission adopted the *Order*, there were four baskets in the price cap rules: common-line, traffic-sensitive, trunking and interexchange. Each basket is subject to a price cap index ("PCI"), which caps the total charges a price cap LEC may establish for the interstate access services in that basket. 47 C.F.R. § 61.42(d). Since that time, the Commission has removed special access from the trunking basket and created a separate special access basket. *See* MCI Br. at 7 n.3.

(2) Pricing Flexibility

The Commission periodically has fined-tuned its price cap policies in an effort both to give the incumbent LECs greater flexibility to compete effectively and to prevent them from exercising their market power to stifle competitive entry and charge unreasonable rates for less competitive services. *Order* ¶ 67 (JA 267-68). The Commission has long believed that retaining regulations longer than necessary contravenes the public interest. *See, e.g., Order* ¶ 144 (*citing Policy and Rules Concerning Rates for Competitive Carrier Services*, First Report and Order, 85 FCC 2d 1, 3 (1980) (*Competitive Carrier First Report*); *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order, 11 FCC Rcd 20730, 20762-63 (1996).

Since it adopted the *Price Cap Order*, the Commission several times has increased the LECs' pricing flexibility and their ability to respond to emerging competition, without significantly increasing the risk of predatory pricing and cross-subsidization. For example, when the Commission originally adopted price caps, it required price cap LECs to offer all interstate special and switched access services at uniform, geographically averaged rates within their study areas as a safeguard against unreasonable rates and predatory conduct.[4] In 1994, in response to the increased competitive opportunities resulting from its expanded interconnection decisions, the Commission permitted price cap LECs to geographically deaverage their rates for special access and switched transport services if the LECs met certain interconnection requirements. *Order* ¶ 58 (JA 262-63). *See* 47 C.F.R. § 69.123; *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454-56.

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[4] A study area is a geographical segment of a carrier's telephone operations. Generally a study area encompasses a carrier's entire service area within a state. *Order* n.152 (JA 262). *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7369, 7452 n.403.

The Commission also gradually expanded the price cap LECs' freedom to modify rates within a pricing basket, first by increasing the allowable rate revisions for lower pricing band indices and then by eliminating the lower pricing indices altogether. *Order* ¶¶ 13, 15 (JA 239-40, 241). *See Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, 9139-41 (1995), *aff'd. Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195 (D.C. Cir. 1996); *Access Charge Reform*, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, 11 FCC Rcd 21354, 21487 (1996) (*Access Charge Reform*).

In addition, the Commission permitted price cap LECs to offer volume and term discounts for special access and switched transport services subject to certain conditions. *Order* ¶ 123 (JA 298-99). *See Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7463; *Expanded Interconnection With Local Telephone Company Facilities*, 8 FCC Rcd 7374, 7433-35 (1993) (*Virtual Collocation Order*). And it relaxed the procedures for introducing new switched access services by permitting incumbent LECs to file petitions based upon a public interest standard (instead of the more stringent general waiver standard), thereby eliminating costly and time-consuming burdens on the incumbent LECs. *Order* ¶ 34 (JA 17-18). *See* 47 C.F.R. § 69.4(g); *Access Charge Reform*, 11 FCC Rcd at 21490 (¶ 309).

(3) Dominant/Non-Dominant Classification

Consistent with the policy determination that it should eliminate unnecessary regulations, the Commission has distinguished between "dominant" and "non-dominant" firms and has afforded them different regulatory treatment. Under current rules, non-dominant LECs and CAPs – unlike dominant carriers – do not have their rates subject to review prior to taking effect and are not required to file tariffs. *See Hyperion Telecommunications, Inc.*, 12 FCC Rcd 8596, 8611-12 (1997). The Commission has determined that carriers are non-dominant if they are

"subject to sufficient competitive pressure so that their performance is, and can be presumed to be, in the public interest without detailed government oversight and intervention." *Competitive Carrier First Report*, 85 FCC 2d at 20 (¶ 55). Non-dominant carriers are those that lack market power to sustain prices either unreasonably above or below costs. *See MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985).

C. The Telecommunications Act of 1996

The 1996 Act "seeks to open for all carriers the local and long distance telecommunications markets to competition...." *Access Charge Reform*, 11 FCC Rcd at 21573 (¶32). The 1996 Act imposes obligations on ILECs to give their competitors access to the ILECs' local networks. 47 U.S.C. §§ 251-252. Section 251(c) envisions three methods of entry into the local exchange markets: competitors may obtain, at wholesale rates, the ILEC's retail services and resell those services; competitors may lease portions of the incumbent's network through the use of "unbundled network elements"; competitors may build their own facilities and interconnect those facilities with the ILEC's network. 47 U.S.C. §§ 251(c)(2)-(4). In addition, the 1996 Act requires ILECs to permit competitors to collocate their facilities on the ILEC's premises. 47 U.S.C. § 251(c)(6).

Congress anticipated in adopting the 1996 Act that increased competition would go hand in hand with reduced regulation. *See* Joint Managers' Statement, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 113 (1996) at 1 (the Act establishes a "pro-competitive, deregulatory national policy framework"); 110 Stat. at 56 (Introductory Statement) (1996 Act is intended "to promote competition and reduce regulation"). The Act directs the Commission to eliminate, or forbear from applying, regulations under certain conditions. For example, the Commission is required to conduct a biennial review of its rules that apply to the operations or activities of

telecommunications service providers and to "repeal or modify any regulation it determines [pursuant to that review] to be no longer in the public interest." 47 U.S.C. § 161. *See also* 47 U.S.C. § 160 (Commission must forbear from applying any of its regulations to telecommunications carriers if it finds that enforcement of the regulations is not necessary to achieve statutory ends and that forbearance is consistent with the public interest).

In a notice proposing to review its regulation of access charges in the light of the 1996 Act, the Commission asserted that its Part 69 access charge rules were "fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create." *Access Charge Reform*, 11 FCC Rcd at 21360 (¶ 6). In anticipation of the development of local competition, and in recognition of the deregulatory goals of the 1996 Act, the Commission proposed to eliminate, "either now or as soon as changes in the marketplace permit, any unnecessary regulatory requirements on incumbent LEC exchange access services." *Access Charge Reform*, 11 FCC Rcd at 21359 (¶ 5).[5] The proceeding before the Court commenced with that notice.

II. The Order Under Review

In 1999, the Commission granted limited additional pricing flexibility to ILECs with respect to their interstate access charges. This decision was the logical next step in the Commission's ongoing effort to coordinate reduced regulation with competitive developments. The regulatory relief the Commission granted was incremental: the services are still subject to tariff filing requirements, and most of the services for which the Commission granted flexibility

[5] The Commission approved some additional pricing flexibility at that time, and noted that "further modifications to the Part 69 rate structure could increase consumer choice, streamline regulation, and increase consumer welfare by increasing incentives for innovation." *Access Charge Reform*, 11 FCC Rcd at 21440-41 (¶18).

remain subject to price cap regulation.[6] The Commission granted some regulatory relief immediately; and it adopted substantive and procedural standards for obtaining additional relief in the future, on proof of specific competitive developments.[7]

A. Immediate Pricing Flexibility

The Commission immediately authorized the LECs to offer substantially deaveraged rates for services in the trunking basket.[8] Previously, price cap LECs could deaverage these rates, but they had to satisfy a rigorous standard in order to establish more than three pricing zones. *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454 n. 413. The Commission now allows price cap LECs to define the scope and number of zones within a study area, provided (1) that each zone, except the highest-cost zone, accounts for at least 15 percent of the price cap LEC's trunking basket revenues in the study area, and (2) that annual price increases within a zone do not exceed 15 percent. *Order* ¶ 21 (JA 244). The Commission concluded that these modest limitations would protect against rate shock and prevent LECs from defining narrow zones that are targeted to specific customers. *Order* ¶¶ 62-63 (JA 264-66). The Commission determined that granting additional flexibility to deaverage rates "enhances the efficiency of the market for those services by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, promotes competition in both urban and rural areas." *Order* ¶ 59 (JA 263).

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[6] In some instances, the Commission reduced the length of time that the tariff had to be on file before it could go into effect. For example, carriers that obtain Phase I or Phase II pricing flexibility are permitted to file tariffs on one day's notice. *Order* ¶¶ 122, 153 (JA 298, 310-11), and price cap LECs may file tariffs on one day's notice for new services. *Order* ¶ 40 (JA 252).

[7] No one has yet petitioned for this additional "Phase I" or "Phase II" relief.

[8] These include the special access services that are now in their own separate special access basket.

The Commission also authorized price cap LECs immediately to introduce new services on a streamlined basis without requiring prior approval or the public interest showing that it had required previously. *Order* ¶ 22 (JA 244). In addition, except as to loop-based services, the Commission eliminated the new services test previously required under section 61.49(f) and (g) of its rules. *Id.* The Commission permitted price cap LECs to begin to offer new services on a streamlined basis, but it required that these services eventually be incorporated into the price cap rate structure. *Order* ¶ 43 (JA 253). The Commission noted that, with the growth of competition, the pre-existing new services requirements could place price cap LECs at a competitive disadvantage, because their competitors are not subject to such restrictions and because they have advance notice of the new services that price cap LECs seek to offer. *Order* ¶ 38 (JA 251). The Commission observed that the pre-existing rules reduce the price cap LECs' incentives to develop and offer new services. *Id.*

The Commission immediately permitted price cap LECs to remove their interstate intraLATA services and certain interstate interLATA services (called "corridor services") from price cap regulations, provided that the price cap LEC had implemented dialing parity for inter- and intraLATA toll services. *Order* ¶ 23 (JA 244-45).[9] Once toll dialing parity was implemented, these services would face sufficient competition to "preclude price cap LECs from exploiting over a sustained period any individual market power they may have with respect to these services." *Order* ¶ 45 (JA 254).[10]

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[9] Dialing parity exists when a customer of a competitive carrier can make a call by dialing the same number of digits that a customer of the LEC would dial to make the same call. *See* 47 U.S.C. § 153(15).

[10] MCI does not raise any objection to this part of the Commission's order.

B. Future Opportunities For Increased Pricing Flexibility

The Commission adopted a framework offering progressively greater pricing flexibility as competition develops further. In general the framework provides for rate relief in two phases and on a Metropolitan Statistical Area (MSA) basis.[11] To obtain pricing flexibility under Phase I or Phase II, the price cap LEC must file a petition demonstrating that certain competitive "triggers" have been met within the MSA. The triggers vary depending on the degree of relief requested (*i.e.*, Phase I or Phase II) and on the services for which pricing flexibility is sought.

(1) Phase I Relief

Phase I relief is potentially available, pursuant to varying triggers, for (1) dedicated transport (*i.e.*, entrance facilities, direct-trunked transport, and the dedicated component of tandem-switched transport service) and special access services other than channel terminations;[12] (2) channel terminations;[13] and (3) common line and traffic-sensitive services and the traffic-

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[11] Each area within the United States is classified as either an MSA or an RSA (Rural Service Area). There are 306 MSAs and 428 RSAs. 47 C.F.R. § 22.909. For the Court's convenience, a map designating MSAs and RSAs is attached as Appendix 1.

[12] Specifically, for these services, the trigger requires the ILEC to show that competitors have collocated facilities (a) in at least 15 percent of the wire centers within the MSA for which the ILEC is seeking pricing flexibility, or (b) in wire centers accounting for at least 30 percent of the revenues for the services for which the ILEC is seeking pricing flexibility. In addition, in each of the wire centers relied on by the ILEC in its pricing flexibility petition, at least one competitor must rely on transport facilities provided by an entity other than the ILEC. 47 C.F.R. § 69.709(b).

[13] To obtain pricing flexibility for channel terminations to the end user, the ILEC must show that competitors have collocated facilities (a) in at least 50 percent of the wire centers within the MSA for which the ILEC is seeking pricing flexibility, or (b) in wire centers accounting for at least 65 percent of the revenues for the services for which the ILEC is seeking pricing flexibility. In addition, in each of the wire centers relied on by the ILEC in its pricing flexibility petition, at least one competitor must rely on transport facilities provided by an entity other than the ILEC. 47 C.F.R. § 69.711(b).

sensitive component of tandem-switched transport service.[14] *Order* ¶ 70 (JA 268-69). Phase I relief authorizes price cap LECs to offer volume and term discounts for these services and to offer these services pursuant to contract tariffs. *Order* ¶¶ 24, 122 (JA 245, 298). Price cap carriers that obtain Phase I relief must make contract tariff rates available to all similarly situated customers, and they must make the discounts available to anyone willing to commit to the specified volumes or commit to the specified term. *Order* ¶¶ 124, 130 (JA 299, 302). They also must continue to offer these services pursuant to price caps. *Order* ¶ 24 (JA 245).

(2) Phase II Relief

Phase II relief is potentially available for dedicated transport and special access services. *Order* ¶ 70 (JA 268-69).[15] The *Order* establishes more stringent triggers for Phase I relief than for Phase II relief. As it did with Phase I triggers, the Commission established more stringent triggers associated with pricing flexibility for channel terminations between the end office and the customer premises than it did for other special access and transport services.[16] Phase II relief

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[14] To obtain pricing flexibility for this third group of services, a competitor must offer service, using their own transport and switching facilities, to 15 percent of the ILEC's customer locations. 47 C.F.R. § 69.713(b).

[15] The Commission sought comment on appropriate bases for granting Phase II relief for common line and traffic-sensitive services. *Order* ¶ 70 (JA 268-69). It has not yet established triggers for granting such pricing flexibility.

[16] Specifically, with the exception of pricing flexibility for channel terminations to end users, the trigger requires the ILEC to show that competitors have collocated facilities (a) in at least 50 percent of the wire centers within the MSA for which the ILEC is seeking pricing flexibility, or (b) in wire centers accounting for at least 65 percent of the revenues for the services for which the ILEC is seeking pricing flexibility. 47 C.F.R. § 69.709(c). To obtain pricing flexibility for channel terminations to the end user, the ILEC must show that competitors have collocated facilities (a) in at least 65 percent of the wire centers within the MSA for which the ILEC is seeking pricing flexibility, or (b) in wire centers accounting for at least 85 percent of the revenues for the services for which the ILEC is seeking pricing flexibility. 47 C.F.R. § 69.711(c). In addition, in each of the wire centers relied on by the ILEC in its pricing flexibility petition, at least one competitor must rely on transport facilities provided by an entity other than the ILEC. 47 C.F.R. §§ 69.709(c), 69.711(c).

permits LECs to offer these services outside of price cap regulation, but carriers still must file generally available tariffs. *Order* ¶ 151 (JA 310).

(3) Collocation Triggers

The competitive triggers that the Commission will use to decide whether to grant Phase I or Phase II relief for special access and dedicated transport services take into account the degree to which competitors have collocated their facilities within the MSA. The degree of collocation offers a guidepost for determining whether there is a competitive presence sufficient to restrain a price cap LEC's incentives to charge unreasonable rates. The Commission found that, for special access and dedicated transport services, the presence of operational collocation arrangements provided the most reliable, verifiable, and available indicator of competitive pressure within the MSA. *Order* ¶¶ 78-87 (JA 272-280). The Commission concluded that "collocation by competitors in incumbent LEC wire centers is a reliable indication of sunk investment by competitors." *Order* ¶ 81 (JA 275-76). The Commission evaluated relevant economic literature and determined that "irreversible or 'sunk' investment in facilities used to provide competitive service is the appropriate standard for determining whether pricing flexibility is warranted." *Order* ¶ 79 (JA 273-74). "In telecommunications, where variable costs are a small fraction of total costs, the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and unlikely to succeed." *Order* ¶ 80 (JA 274-75). The Commission explained that the presence of collocation arrangements indicated significant financial investment. *Order* ¶ 81 (JA 275-76).

The Commission considered other proposed triggers, and concluded that none was preferable to the collocation triggers it selected. *Order* ¶ 87 (JA 279-80). In particular, the Commission rejected proposals that, in order to receive pricing flexibility, LECs must

demonstrate that they no longer possess market power in the provision of the relevant access service – the test the Commission has used to make dominant/non-dominant determinations. *Order* ¶ 90 (JA 281-82). The Commission noted that such showings were burdensome and controversial, and that the costs of delay that would result from requiring such showings outweighed the costs of granting the limited pricing flexibility at issue without such a showing. *Order* ¶¶ 90, 151-152 (JA 281-82, 310). The Commission also rejected proposals that would have required LECs to show that they had lost market share to competitors. *Order* ¶ 103 (JA 289). The Commission noted that such data was not presently available, and it declined to defer granting pricing flexibility until it was. *Id.*

The Commission established a different trigger for Phase I pricing flexibility[17] for common line and traffic-sensitive services and the traffic-sensitive components of tandem-switched transport service.[18] That trigger considers the extent to which competitors offer service primarily or exclusively over their own facilities to ILEC customer locations within the MSA. *Order* ¶¶ 108, 113 (JA 291, 293). Competitors must actually offer service to a 15 percent of ILEC customer locations to satisfy the trigger. *Order* ¶ 120 (JA 296).[19]

The Commission established this separate trigger because it found that it could not look solely to the degree of collocation to determine whether there was sufficient competition for common line and traffic-sensitive services to constrain the ILEC's prices. Competition for those

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[17] As noted above, the Commission has not established triggers for obtaining Phase II relief for common line and traffic-sensitive services.

[18] We hereafter use the phrase "traffic-sensitive services" to include the traffic-sensitive components of tandem-switched transport service.

[19] The trigger is not met if competitors are merely capable of offering service. On the other hand, the trigger does not require the price cap LEC to demonstrate that competitors actually provide service to a certain percentage of customers. *Order* ¶ 120 (JA 296).

services was more recent than competition for shared access and dedicated transport, and the Commission could not predict that it would develop in the same manner. *Order* ¶ 110 (JA 292). Thus, the Commission found that it needed to account for the possibility that market entry would occur via "competitors that have wholly bypassed incumbent LEC facilities as well as competitors that collocate in incumbents' wire centers so as to provide service over unbundled loops." *Id.* The Commission concluded that there was sufficient evidence of sunk investment by competitors to warrant Phase I pricing flexibility if they provided common line or traffic-sensitive services "either entirely over their own facilities or by combining unbundled loops with their own switching and transport...." *Order* ¶ 112 (JA 292).

III. Forbearance Order

Several BOCs filed petitions for forbearance, pursuant to 47 U.S.C. § 160, while the *Pricing Flexibility* proceeding was pending. They asked the Commission to forbear altogether from applying tariff filing requirements and price cap regulation to high capacity special access and dedicated transport services in specific MSAs. On November 22, 1999, after the Commission had adopted the *Pricing Flexibility Order* granting all price cap LECs substantial relief from regulation, the Commission denied the requests for forbearance. *Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, Memorandum and Order, 14 FCC Rcd 19947 (1999) (*U S West Forbearance Order*). That decision also is the subject of petitions for review before this Court, which will be heard by the same panel that will hear this case and on the same day. *AT&T Corp. v. FCC*, Nos. 99-1535 and 00-1090.

SUMMARY OF ARGUMENT

The Commission established rules that provide additional pricing flexibility to LECs that are subject to price cap regulation. The Commission determined that, in light of the 1996 Act, which significantly increases opportunities for competition in the local exchange and exchange access markets, the Commission should offer price cap LECs additional flexibility to respond to competition. The Commission recognized that continuing to impose regulations that were no longer necessary was contrary to the public interest because unnecessary regulations perpetuate inefficiencies in the market and interfere with the development and operation of markets as competition develops. *Order* ¶¶ 67, 144 (JA 267-68, 307). The Commission adopted a multi-phase approach that at each step (1) provided appropriate regulatory relief in light of competitive developments, and (2) imposed (or retained) conditions to ensure that consumers were not harmed by such relief.

The Commission established predictive rules that would permit price cap LECs, in the future, to obtain additional pricing flexibility if the LECs could demonstrate that certain competitive "triggers" were satisfied. The triggers consider the extent to which competitors have invested in competitive facilities and established collocation arrangements within an MSA. The Commission determined that collocation could serve as a proxy for measuring competitive pressure on the ILEC. The Commission reasonably determined that, where competitors had significant "sunk investment" in an MSA, this competitive pressure would constrain the ILEC's incentive to set unreasonable rates.

Petitioners MCI WorldCom, Inc., AT&T Corp., Time Warner Telecom Inc. and their supporting intervenors (MCI) do not dispute that collocation facilities are a reliable measure of competitive entry. MCI contends, however, that the Commission was required to consider loss

of market share before it could grant the pricing flexibility it did. MCI does not identify any statutory requirement, nor any relevant past Commission decisions, in support of its argument. MCI ignores numerous past decisions in which the Commission increased LECs' pricing flexibility, without making findings about market share. MCI argues instead that the Commission was obligated to use the same type of analysis it used in deciding whether AT&T was non-dominant. The Commission reasonably concluded that the costs associated with such market share determinations outweighed the benefits, in light of the limited relief granted and the protections it retained or added to ensure that carriers do not charge unreasonable prices.

The Commission also determined that, for certain types of service offerings, consumers would benefit from a grant of immediate pricing flexibility. The Commission permitted price cap LECs to introduce new services on a streamlined basis, so that consumers would have more rapid access to the new offerings and LECs could respond better to competitive offerings. The Commission also expanded price cap LECs' ability to charge deaveraged rates, which more accurately reflect the costs associated with serving a particular geographic area. The Commission conditioned both reforms in ways that would ensure that consumers are protected.

STANDARD OF REVIEW

In ruling upon the petitioners' challenge to the Commission's pricing flexibility *Order*, the Court's role is to determine whether the FCC acted within its authority and considered the relevant factors. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 415-16 (1971); *National Ass'n of Regulatory Utility Comm'rs v. FCC*, 737 F.2d 1095, 1140-41 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985)(*NARUC*). "The FCC's judgment about the best regulatory tools to employ in a particular situation is ... entitled to considerable deference from the generalist judiciary." *Western Union International, Inc. v. FCC*, 804 F.2d 1280, 1292 (D.C. Cir.

1986); *see also NARUC v. FCC*, 737 F.2d at 1140-41. That is because "agency ratemaking is far from an exact science and involves policy determinations in which the agency is acknowledged to have expertise." *Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 163 (D.C. Cir. 1995) (quotation omitted), *cert. denied*, 516 U.S. 1112 (1996). The Court's role is to "patro[l] the perimeters of an agency's discretion," not to second guess the agency as to its choice among permissible solutions. *NARUC v. FCC*, 737 F.2d at 1140, particularly where, as here, several features of the Commission's action that petitioners challenge reflect predictive judgments about the regulated industry for which complete factual support is neither possible nor required. *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 814 (1978).

Applying this governing standard of review, the Court should deny the petitions for review.

ARGUMENT

I. THE COMMISSION'S PRICING FLEXIBILITY DECISION WAS CONSISTENT WITH APPLICABLE LAW AND WITH PRIOR COMMISSION ACTIONS.

The Communications Act requires that rates be just and reasonable, and authorizes the Commission to prescribe regulations "as may be necessary in the public interest to carry out the provisions of this Act." 47 U.S.C. § 201(b). At the same time, the Commission is responsible for implementing the "procompetitive, deregulatory" goals of the 1996 Act. Joint Managers' Statement, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 113 (1996) at 1. *See also* 110 Stat. at 56 (Introductory Statement) (1996 Act is intended "to promote competition and reduce regulation"); 47 U.S.C. §§ 160, 161. The Communications Act, as amended by the 1996 Act, thus requires the Commission to consider both the public interest benefits of reducing regulations and the public interest benefits to be achieved through the continued application regulations